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March 25, 2004

Edward Gramlich
Governor
Federal Reserve System
Washington, D.C. 20551

Dear Governor Gramlich:

It was a pleasure to meet with Governor Bernanke, you and Federal Reserve staff several weeks ago in D.C. California Reinvestment Committee members thought it was a fruitful interchange. CRC appreciates the efforts of the Federal Reserve System to review the increasingly complex activities of financial institutions to identify the intermingling of subsidiaries and affiliates with lending, investments and services. We value the opportunity for community activists to meet with you and exchange views and experiences.

In terms of the review of the issues discussed at the meeting, CRC members would like to highlight a few key issues:

- **CRA Regulations:** CRC opposes the proposed changes to the CRA regulations ~~which would increase the asset threshold from \$250 million to \$500 million for~~ banks to be eligible for a small bank exam. The proposed changes also include an anti-predatory screen that instead of severely penalizing banks for predatory lending would, in our view, actually permit abusive lending.

Under the proposed changes, more than 1,100 banks would be transferred to small bank status and would no longer have to comply with the investment and service tests on their CRA exams. The proposed changes also would delete the holding company part of the definition of a small bank. CRC is concerned that many small banks in rural areas would no longer have a responsibility to address investment and service needs of the communities in which they serve and receive deposits.

The proposed changes define "predatory" lending as loans based on the foreclosure value of the collateral and the borrower's ability to repay. Both conditions have to be met before the regulators will downgrade on a exam. Defining predatory lending without taking into account other abusive practices legitimizes it within a narrow scope. The proposed changes also lack a threshold establishing the amount of abusive lending that would result in a downgrade.

CRA has proven to be a powerful tool for requiring banks to lend, invest and provide financial services in low income and people of color communities. Weakened CRA regulations would leave our communities open to second tier financial products and services (predatory lending, payday loans, check cashers, etc.) and would deny local organizations access to financial products that could assist with redevelopment efforts

- ▶ Predatory Lending: CRC remains very concerned about predatory lending practices, including the prevalence of abusive loan terms and sales tactics, and the reality that banks and mortgage companies are making subprime loans to prime customers. The recent Government Accounting Office report, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending* (“GAO report”) notes that nearly a quarter of subprime loans are originated by non bank mortgage lending subsidiaries of bank or financial holding companies, and that environment in which these lenders operate is relatively unregulated. Recent efforts by the Office of the Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTS) to preempt state anti predatory and consumer protection law vis a vis federally chartered banks and their subsidiaries will no doubt harm consumer interests and the preservation of home equity in California. CRC’s Fair Lending Principles, attached, outline the standards that lenders should follow with regard to subprime lending.

Additionally, CRC believes that banks and their Wall Street affiliates must develop effective due diligence screens to ensure they are not financing predatory lending. The GAO report asserts that in 2002, 63% of subprime loans, totaling \$134 Billion, were securitized. The report also states that due diligence by securitizing firms is meant to merely ensure compliance with existing law, and not to weed out predatory loans. As long as Wall Street remains willing to securitize predatory loans and accept the occasional lawsuit as the cost of doing business, predatory lending will continue to thrive. Banks and their affiliates, in particular, must do more to ensure they are only financing good loans, and doing business with companies that are committed to fair lending. Bank involvement in subprime goes beyond origination, and includes purchasing, servicing, securitizing, serving as trustee, and investing in subprime loans and other alternative financial products. CRC proposes Fair Financing Principles, attached, to regulate the secondary market conduct of financial institutions.

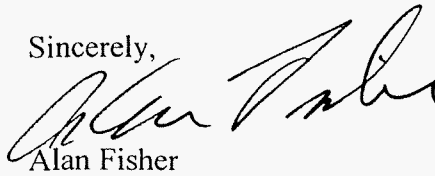
- ▶ Community Investment: At a recent affordable housing conference, Vickie Tassan, a senior vice president at Bank of America said: “You’re either with us or against us. I don’t want to hear one more community group tell me something negative and then ask for \$400,000 a week later. That just doesn’t work any more.” CRC is concerned that these comments effectively appear to require community groups to be in agreement with a bank in order to have a working relationship with them. In light of these comments and the pressure exerted on nonprofit organizations by bank foundations, we are requesting

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- that the Federal Reserve Board monitor an institution's grant making in the years before and after a merger particularly if hearings are held.
- ▶ NonBanks, Enforcement and Preemption: CRC members witness a two tiered banking system, where banks serve upper income communities, and leave their bank affiliates to serve low income and minority communities. Bank affiliates make money for the bank, but charge significantly more to consumers. The situation cries out for more oversight while the OCC and OCC have preempted institutions from state oversight. The GAO recently urged the Federal Reserve System to more closely examine nonbanks. CRC urges the Federal Reserve to step into this breach in the interest of consumers.
 - ▶ Banking without CRA: As we discussed, we do not believe that financial institutions would continue all and/or expand their CRA activities without continued regulations the Federal Reserve and the other regulators. There is strong pressure from Wall Street for high profits that keeps financial institutions from doing many already worthwhile CRA activities.
 - ▶ Community Contacts: Few CRC members and even fewer CRC staff see federal regulatory examiners when they are reviewing the activities of financial institutions operating in California. CRC recommends: 1. Utilize community organizations to educate examiners on community development and community needs. and 2. Examiners should make community contacts annually with at least twenty community-biased organizations in each **MSA** in which the financial institution operates.

We appreciate the opportunity to identify the above issues and meet to discuss them. Attached are CRC's Fair Lending Principles and Fair Financing Principles. Please contact us with any questions on the above.

Sincerely,



Alan Fisher
Executive Director

cc: Dolores Smith, Federal Reserve
Joy Hoffman, Federal Reserve

California Reinvestment Committee

FAIR LENDING PRINCIPLES FOR BANKS, THRIFTS, AND SUBPRIME LENDERS

1. Stop targeting minorities, low-income, and the elderly for sub-prime lending.
 - Provide separate HMDA data on subprime lending to the public, whether subprime lending occurs through bank, thrift, subprime subsidiary or affiliate.
 - Adapt marketing and retail location of parent bank and subsidiaries/affiliates to balance targeting to minorities.
 - Support credit and mortgage counseling programs.
 - Conduct periodic review of applications taken, originations, and denials by neighborhood and borrower race and income to ensure credit is being made available in a balanced fashion.
2. Offer borrowers the best product for which they qualify.
 - Agree to offer a full-spectrum of loan products, including A-paper loans.
 - Develop a referral system to match the consumer to the most appropriate product.
 - Compensate loan personnel and management on a basis that furthers the above goals.
 - Ensure adequate representation of wholesale staff and retail facilities to make prime credit available to underserved communities.
 - Establish a rescue fund to compensate victims of predatory lending.
3. Stop onerous prepayment penalties:
 - Offer every borrower the option of a loan without prepayment penalty. Prepayment penalties provisions must result in a bona fide benefit to the borrower, such as a truly lower interest rate.
 - Limit prepayment penalties to the first 3 years of the loan
 - Prohibit prepayment penalties after a change in the initial interest rate of the loan
 - Charge no more in prepayment penalties than the following: 3% of the loan amount if paid within the first year of the loan; 2% of the loan amount within the first two years of the loan; and 1% of the loan amount within the first three years of the loan.
 - Lenders refinancing a note they hold should not assess a prepayment penalty.
4. End flipping.
 - Stop refinancing loans when not in the “best interest of the borrower,” considering lower monthly payments, lower blended interest rates, assistance in avoiding foreclosure, and cash out to the borrower.
 - Do not encourage borrowers to refinance unsecured debt into the new loan as a means of increasing the loan size and related points, fees, and commissions.
 - Develop a second mortgage product for owners with special low or no cost mortgages that wish to access the wealth in their homes without losing the benefit of their first mortgage.

5. End the sale of single premium credit insurance products as part of the home loan.
 - Offer insurance product only if payments are made monthly and if sale of product occurs at least one week after a home loan closing
6. End mandatory arbitration provisions.
7. Ensure borrowers are able to repay the loan.
 - Underwriting should screen out borrower with 50% or greater debt to income ratios, unless lender can document why lender reasonably believes borrower will be in a better position to afford the loan in the future.
8. End excessive points and fees
 - Points and fees should not exceed 3% of the loan amount
9. Stop predatory practices of brokers
 - Commit to testing and loan reviews of brokers that consider customer complaints.
 - Compensate loan personnel and management on a basis that does not reward predatory practices and places penalties on those that do.
 - Place a cap on fees to brokers.
 - Require fair lending training of all brokers.
 - Mandate a broker code of conduct agreement.
 - End yield spread premium payments or other compensation that rewards brokers for steering borrowers to higher cost products and larger loans.
10. Agree not to purchase or invest in predatory loans
 - Develop due diligence to ensure no predatory loans are purchased or invested in as part of a mortgage backed security. Ensure all affiliated institutions, including securities firms, are not underwriting, securitizing, or otherwise facilitating the financing of lending that violates these principles.
 - Make borrowers whole when presented with evidence that these principles have been violated.

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California Reinvestment Committee
Subprime Lending, Securitization, and Secondary Market
Fair Financing Principles

Banks Facilitate Subprime Lending in Several Ways

- Originator of subprime loans
- Issuer of subprime securities
- Underwriter of subprime securities
- Servicer of subprime loans and securities
- Trustee for subprime securities

Banks Routinely Finance Predatory Loans on the Secondary Market

A quick sampling of various bank subprime securitization deals in 2003 shows loans containing:

- High interest rates - beginning at 14%, adjusting up to 20%, never going below 13%
- Prepayment penalty provisions:
 - on up to 80% of the loans in some pools
 - that extend beyond the initial interest rate on adjustable loans
- Combined Loan To Value ratios that are at or exceed 100%.
- Balloon payments
- Negative amortization
- Low document and stated income loans that are vulnerable to abuse (brokers inflate income)
- Loans by lenders who have been, and are, the subject of litigation for predatory practices.
- Servicing done by problematic servicers, that are the subject of litigation.

Banks and Affiliates Must Develop Strong Screens to Weed out Predatory Loans:

Banks should agree not to issue, underwrite, service, or serve as trustee on pools containing:

- High Points and Fees in excess of 3% of the loan amount (including prepayment penalty provisions and yield spread premiums)
- High Interest Rates that are 3% or more above the prime rate
- Mandatory Arbitration provisions
- Prepayment Penalty Provisions
 - where consumer had no option for loan without a prepayment penalty provision
 - that last beyond 2 years
 - that amount to more than 2% of the loan amount, and
 - that last beyond the initial interest rate of the loan
- Financing of points and fees in excess of 2% of the loan amount
- Loan terms a borrower is not able to reasonably repay
- Loan terms that provide no net tangible benefit for the borrower
- Originators that are the subject of litigation for predatory practices

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